

UACES 42nd Annual Conference

Passau, 3-5 September 2012

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**Conference UACES 2012, University of Passau
Panel “EU enlargement IV”**

State aid control in South-East Europe: The Endless Transition

Abstract

During the last decade the European Commission has asked the countries of South-East Europe (SEE) to introduce an internal system of State aid control. Through a cross-country comparative the paper analyzes the effectiveness of such national monitoring systems. The decentralization of State aid enforcement, successfully carried out in Central and Eastern Europe (CEECs) by national monitoring authorities during the EU pre-accession phase, could not be exported to the SEE countries. In particular, the paper concludes that the lack of a clear timing for EU accession for most of SEE countries has hampered the enforcement of State aid rules. The paper argues that State aid control should thus be carried out by a supranational institution, even during the EU pre-accession phase.

Number of words including footnotes: 16.093

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1. Introduction

During the last decade, countries from South-East Europe (SEE) have introduced internal systems of State aid control.¹ The obligation to introduce such internal monitoring systems derived from the Stabilization and Association Agreements (SAAs) concluded by the European Union (EU) with these countries.² In particular, following the example of the previous EU enlargement to the countries of Central and Eastern Europe (CEEC), the European Commission has emphasized that the introduction of an internal monitoring system of State aids was an important precondition for the accession of SEE countries to the EU.³ Such monitoring system would be transitional; the State aid monitoring activity would later be carried out by the European Commission following the accession of SEE countries to the EU. An internal State aid control imposes a self-constraint on the local Government in relation to its ability to intervene in the economy through its budget expenditure. The EC founding fathers had serious doubts concerning the ability of the Member States (MS) to self-constrain their budget expenditures, and consequently the Treaty of Rome delegated the State aid monitoring activity to a supranational authority like the European Commission.⁴ From this point of view, the temporary decentralization process of State aid enforcement experimented in CEECs and in SEEs represents an exception to this logic.

¹ The expression SEE indicates the countries of the Balkan peninsula which have not joined the EU yet, namely Croatia, Rep. Macedonia, Albania, Serbia, Montenegro, Bosnia and Herzegovina (BiH), Kosovo. On the basis of the conclusions of the European Council of Thessaloniki in 2003 all the countries of the Balkan peninsula have a potential EU candidate perspective.

European Council of Thessaloniki, 16.6.2003, Presidency Conclusions, Thessaloniki Agenda: Moving towards European Integration. The document is available at:

http://ec.europa.eu/enlargement/enlargement_process/accesion_process/how_does_a_country_join_the_eu/sap/thessaloniki_agenda_en.htm (19.01.2012).

² The SAA represent the first step of the integration of the SEE countries into the EU. The EU has concluded SAA with all the SEE countries, with the exception of Kosovo. The ratification of the SAA with BiH is currently pending, and the latter is replaced by an Interim Agreement which is currently in force. Finally, the EU has recognized to Montenegro and to the Rep. of Macedonia the candidate status, while the negotiations with Croatia has been recently concluded and the country will join the EU in 2013.

For further information concerning the enlargement process see:

http://ec.europa.eu/enlargement/countries/index_en.htm (19.01.2012).

³ SCHUTTERLE PETER, *Implementing of the EC State aid Control – An Accession Criterion*. Vol 1, European State Aid Quarterly 79-86 (2002).

⁴ State aid rules are included in Art. 107 and 108 of the Treaty of the Functioning of the European Union. The text of the two articles has not been substantially modified since the Treaty of Rome in 1957.

Consolidated Version of the Treaty on the Functioning of the European Union. The Treaty was signed in Lisbon on 13.12.2007, and it entered into force on 1.12.2009. OJ C 115/47, 9.5.2008.

The paper argues that unlike CEECs the introduction of an internal system of State aid control in SEEs has proved not to be effective. In particular, the hypothesis discussed in the paper is that a State aid system can be effectively enforced in the EU candidate countries only if the latter have a clear time frame to join the EU; a clear perspective of EU accession represents the main incentive which encourages Governments of EU candidate countries to self-constrain their budget expenditures. From this point of view, the endless transition towards EU membership that most of the SEE countries are currently facing undermines the incentive to introduce an effective system of State aid control.

“Effectiveness” of a system of State aid control should be measured in accordance with two criteria: the ability of the national State aid authority to actively enforce the State aid law even in politically sensitive cases, as well as the compliance with the goals stated by the European Commission in the 2005 European Commission’s State aid Action Plan (SAAP).⁵ The latter document emphasized the importance of achieving a long term reduction of the amount of subsidies granted by EU MS in comparison to their GDP,⁶ as well as a shift from vertical aids targeting specific industries to horizontal aids;⁷ the latter are not discriminatory, and thus they are more effective in solving market failures without affecting competition among market players.⁸

⁵ European Commission, *State aid Action Plan. Less and Better Targeted State Aid: A Roadmap for State Aid Reform 2005-2009*. Consultation document COM(2005) 107 final. Published in Brussels on 7.6.2005. The document is available at:

<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2005:0107:FIN:EN:PDF> (19.01.2011).

⁶ In SAAP, the European Commission justified this policy choice by referring to the conclusions of the 2005 European Council, which called “Member States to continue working towards a reduction in the general level of State aid, while making allowance for any market failures. This movement must be accompanied by a redeployment of aid in favour of support for certain horizontal objectives such as research and innovation and the optimisation of human capital. The reform of regional aid should also foster a high level of investment and ensure a reduction in disparities in accordance with the Lisbon objectives”. In addition, the European Commission argued that a reduction of the amount of State aids granted by MS aimed at making the EU companies more competitive, in line with the objectives defined by the 2004 European Council in Lisbon.

Ibid, para. 13, 14.

⁷ Horizontal aids are the categories that MS grant to every economic sector in order to achieve a specific public interest objectives. Horizontal aids are granted to support environment protection, supporting training of workers, research and development projects, aids schemes to under-developed regions... On the contrary, vertical aids target a specific industry. Vertical aids are often granted by local Governments under the lobby pressures of the companies active in a specific industry, which without the granted aids would not be able to cope with the competition from foreign competitors and thus they would not be able to stay profitably in the market.

⁸ SAAP argues that in a competitive environment the market should be able to self-regulate itself without the need of MS intervention. However, MS can intervene in the market by providing aid when self-regulation mechanism in the market does not regulate properly, and thus there are market failures. Examples of market failures are the existence of imperfect information, coordination problems and market power by one of the market players. In addition, MS can finance the provisions of certain public goods which are beneficial for the society, but the competition in the market cannot guarantee the provision of such goods.

Ibid, page 7.

Most of the SEE countries have fully transposed the EU State aid *acquis*. However, the system of enforcement of these rules remain “ineffective”; in particular, as we will see in the following pages, the introduction of an internal system of State aid control has not helped the SEE countries in achieving a reduction of the overall amount of aids granted in comparison to their GDP and a shift towards horizontal aids.

The paper does not aim at discussing the suitability of EU State aid rules to the economic development needs of SEE as countries in transition/emerging economies. Therefore, the paper does not analyze whether a more lenient approach in the assessment for certain types of aids would be needed for the SEE countries (i.e. restructuring aids to formerly State owned companies subject to programs of privatization; aids to finance important infrastructure projects in order to attract FDIs). The normative argument from which the paper departs is that the SEE countries are required to fully enforce the EU *acquis* being EU candidate countries. However, the paper criticizes the European Commission’s policy choice of requiring SEE countries to establish national State aid monitoring systems as the best policy option to facilitate the compliance of EU State aid rules by these candidate countries.

The paper will conduct an institutional analysis of the challenges faced by the newly established State aid monitoring authorities in SEE countries in enforcing the EU State aid *acquis*. In particular, after an historical overview of the main trends in the enforcement of State aid rules in the EU, the paper will compare the degree of enforcement of State aid rules in the SEE countries. The comparative analysis will rely on the State aid laws and sub-laws adopted in SEE, on the annual reports drafted by the State aid monitoring authorities, as well as on the progress reports adopted every year by the European Commission in relation to the readiness of SEE countries to join the EU. The paper will conduct a cross-country comparative analysis of the enforcement trends of State aid rules in SEE countries, rather than describing the State aid law on a country by country basis.

An extensive literature exists in relation to the enforcement of State aid rules in CEECs before and after the 2004 EU enlargement;⁹ on the other hand, the literature on SEE countries is

⁹ In relation to the enforcement of State aid rules in CEECs, see for instance: VON BORRIES REIMER, *State Aid Control in Romania*, Vol 3 European State Aid Law Quarterly 509-517 (2006); PACZKOWSKA-TOMASZEWSKA ALEKSANDRA, KRZYZTOF JAROS, KRZYSZTOF WINIARSKI, *Monitoring State Aid in Poland*, Vol 4 European State Aid Law Quarterly 669-682 (2006); JAGODIĆ-LEKOČEVIĆ LEA, PELKA PIOTR, VÖSU AIME,

still quite limited.¹⁰ In particular, so far only few academic articles have wondered whether the pre-enlargement decentralization process of State aid rules followed in CEECs could be effectively exported to SEE countries as well.¹¹ The paper aims at providing a contribution to this debate, and thus at filling a gap in the literature.

2. State Aid Control in the EU: How Did It Develop?

2.1. EU State aid control: from under-enforcement to an effective supranational policy

As argued in the previous section, since the Treaty of Rome the EU MS have delegated the exclusive enforcement of State aid policy to the European Commission. According to Spector, by accepting this enforcement system of State aid rules the EU MS implicitly recognized their inability to resist national lobbies, constantly pressing national Governments to subsidize certain economic sectors.¹² Through this “paternalistic” approach, EU MS avoided a subsidies race, which would jeopardize the free competition within the common market.¹³

In spite of the exclusive competence of the European Commission, State aid policy remained *de facto* unenforced for a number of decades. In particular, MS did not comply with their duty under Art. 108(3) TFEU to inform the European Commission in relation to any plan to grant or to alter existing aid schemes. In addition, as recognized by former Commissioner Kroes, MS seldom implemented EU Commission’s Decisions declaring aids incompatible with the common market by recovering the aids from the recipients.¹⁴ This situation has progressively improved. An

Future Role of the Former National Monitoring Authorities and Existing Aid in Slovenia, Poland and Estonia, Vol 3, European State Aid Law Quarterly 375-384 (2004).

¹⁰ See, for instance: DAJKOVIĆ IRENA, *Comments on the New State Aid Law in Serbia in the Context of Serbia’s Accession to the EU*, Vol 2 European State Aid Law Quarterly 347-360 (2010); SCHÜTTERLE PETER, *State Aid Control in Western Balkans and Turkey*, Vol 2, European State Aid Law Quarterly 255-263 (2005).

¹¹ See, in particular: CREMONA MARISE, *State Aid Control: Substance and Procedure in the Europe Agreements and the Stabilisation and Association Agreements*, Vol 9, Issue 3, European Law Review, 265-287 (2003).

¹² SPECTOR DAVID, ‘State Aids: Economic Analysis and Practice in the European Union’. In Vives Xavier (ed.), *Competition Policy in the EU: Fifty Years on in the EU*. Oxford Scholarship Online (2009). At 176-202.

¹³ *Ibid.*

¹⁴ In a speech given to the University of Leiden in 2005 in the aftermath of the SAAP adoption, Commissioner Kroes stated: ‘We should not forget, in this context, that only a small percentage of all aids banned by the Commission are ever recovered. If aid is condemned as illegal and incompatible, you would normally expect it to be recovered, but unfortunately, this doesn’t often happen.’

KROES NEELIE, *Reforming Europe’s State Aid Regime: an Action Plan for Change*, Vol 3 European State Aid Law Quarterly 386-390 (2005).

important step from this point of view was the adoption of the Regulation 659/99, whereby EU MS accepted to be bound by a clear system of *ex-ante* notification of new State aids to the European Commission, as well as by a stand-still obligation which requires the MS not to implement the aid scheme before receiving the authorization from Brussels.¹⁵ Furthermore, in spite of the political sensitivity of State aid control, the European Commission has been successful in preserving its autonomy from the MS. From this point of view, Blauberger argues that the European Commission successfully “de-politicized” State aid control by creating a system of norms and case law that the European Commission relies upon to justify the outcome of its analysis.¹⁶ In particular, the author observes that in its Decisions the EU executive body constantly refers to its Guidelines concerning certain types of aids, as well as to its previous Decisions and to the Judgments of the European Court of Justice (ECJ). In addition, the EU Commission has usually placed State aid enforcement within broader EU policy strategies (i.e. the reduction of State aids invoked in SAAP was framed in the light of the Lisbon agenda), and it has actively cooperated with third parties interested in the proper enforcement of State aid rules (i.e. identification of illegal State aids through private enforcement of Art. 108 TFEU in national courts).¹⁷ These factors have helped the EU Commission to preserve the exclusive control of State aids even in particularly difficult times. For instance, in October 2008 the European Commission adopted a temporary setting of rules applicable to specific categories of financial institutions which needed a more lenient State aid control due to the financial crisis. However, by limiting the application of the exceptional rules to financial institutions, the EU Commission has successfully managed to preserve the existing State aid framework in relation to the other sectors of the economy.¹⁸

¹⁵ Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty. OJ L 83, p. 1. See art. 2 and 3.

¹⁶ BLAUBERGER MICHAEL, *Of ‘Good’ and ‘Bad’ Subsidies: European State Aid Control through Soft and Hard Law*, Vol. 32, Issue 4, West European Politics, 719-737 (2009).

¹⁷ SMITH MITCHELL P., *Autonomy by the Rules: the European Commission and the Development of State Aid Policy*, Vol. 36, N. 1, Journal of Common Market Studies 55-78 (1998).

¹⁸ From October 2008, the European Commission issued a number of communications, which defined temporary rules to allow the recapitalization of banks affected by the financial crisis. IN December 2011, EU Commission extended the length of these rules; however, the latter remain a “temporary” set of rules, which will remain into force during the period of the financial crisis, rather than permanent derogations from the State aid rules.

http://ec.europa.eu/competition/state_aid/legislation/temporary.html (19.1.2012).

LUJA RAYMOND, *State Aid and the Financial Crisis: Overview of the Crisis Framework*, Vol. 2 European State Aid Law Quarterly, 145-159 (2009).

2.2. The “more economic approach”: towards less aids

The adoption of the SAAP represented a major milestone in the development of State aid policy in the EU. In particular, SAAP aimed at achieving two main objectives: a reduction of the overall amount of subsidies granted by MS and a decentralization of State aid enforcement.¹⁹

The first objective was achieved through the introduction of a “more economic approach” to State aid analysis. During the previous decades, the EU Commission analyzed the notified State aids through a “legalistic” approach, whereby every subsidy which satisfied the conditions of Art. 107(1) TFEU was declared unlawful,²⁰ unless it fell within one of the exceptions provided by Art. 107(2),(3) TFEU;²¹ the EU Commission thus analyzed whether the goals of the notified aid satisfied the conditions of para. 2 and 3, but *de facto* it did not assess the effects of the granted aid on the competition in the market. SAAP modified this type of “mechanical” analysis by introducing three steps “balancing test” to assess the compliance with Art. 107(3) conditions.²² The three steps were the following ones: the aid aimed at addressing a well-defined objective of common interest; the aid was suitable to achieve such objective (i.e. it was the appropriate measure; it was proportionate and it created an incentive effect for the aid beneficiary to change its behavior in the future); the distortion on competition and on trade caused by the aid was limited. The innovative aspect of the balancing test was the second step, which required the EU Commission to elaborate a counterfactual scenario, in order to assess whether the common objective would have been achieved even in the lack of the granted aid.²³ The consequence of the counterfactual analysis was that MS had to face a higher burden of proof to show that the notified

¹⁹ *Supra*, SAAP, section I.2 (para. 13-17).

²⁰ Under Art. 107(1) TFEU, a MS grants a State aid when 4 cumulative conditions are satisfied: 1) the aid implies the use of State resources; 2) the aid is granted by a MS body, a central or local institution 3) the aid distorts competition by discriminating certain undertakings. The ECJ has interpreted this criterion under the “market investor principle”: aid is not discriminatory if a private investor would have granted the same aid under standard market conditions; 4) the aid affects the intra-Community trade. If the aid satisfies these four conditions is deemed to be incompatible with the common market, and thus it is unlawful.

²¹ Para. 2 of Art. 107 TFEU three types of aids which are considered *per se* compatible with the common market, and thus they can be exempted from Art. 107(1) prohibition. The three types which satisfy the exemption included in para. 2 are: 1) aids which have a social character, granted to individual consumers without any discrimination; 2) aids granted by MS to reconstruct areas affected by natural disasters; 3) aids granted by Germany to support the reconstruction of eastern Germany following the reunification.

Para. 3 of Art. 107 TFEU includes a list of five types of aids which may be considered compatible with the common market. Unlike para. 2, the assessment of compatibility is carried out by the European Commission.

²² The three steps approach was explained by staff working paper published in 2009 by DG Competition.

European Commission, *Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3*. Para. 9. The text of the paper is available at:

http://ec.europa.eu/competition/state_aid/reform/economic_assessment_en.pdf (23.01.2011).

²³ *Ibid*, para. 17.

aid was an indispensable and proportionate measure, and thus that in the lack of such measure the common objective would have not been achieved. Besides the introduction of the balancing test, SAAP emphasized that a MS could grant an aid only when the free competition in the market could not allow the achievement of the common objective (i.e. a market failure created an obstacle to the achievement of the common objective).²⁴ For instance, a MS could subsidize an operator in providing public transports in an under-populated area. However, the MS should prove that the lack of local demand created a market failure (i.e. the lack of profitability of the service would have caused the transport operator to exist the market in the lack of the granted subsidy), which would have not allowed the achievement of the common objective (i.e. ensuring the provision of a minimum level of public transport services even in under-populated areas). Finally, SAAP clearly stated its preference for horizontal types of aids in comparison to vertical aids, since the first ones could address a market failure without discriminating any operator in the market.²⁵ Horizontal types of aids were, in fact, later excluded from the duty of notification under the General Block Exemption Regulation adopted by the European Commission in 2008.²⁶

The introduction of the balancing test, the focus on market failures and a clear preference for horizontal aids shared the common objective of encouraging the MS to reduce the amount of aids granted, in particular in relation to those ones which had a vertical nature. SAAP has been criticized by a number of authors. For instance, Heimler has criticized the fact that the EU Commission takes in consideration only the ability of the aid to solve a market failure, without assessing the impact of the subsidy on the competition in the market.²⁷ Moreover, Kaupa has criticized the fact that the EU Commission only relied on the conclusions of the European Council as legal basis for its strategy of State aid reform, twisting the words of Art. 107(3)

²⁴ *Supra*, SAAP, para. 23.

²⁵ *Supra*, SAAP, section II.

²⁶ Commission Regulation (EC) No 800/2008 of 6 August 2008 declaring certain categories of aid compatible with the common market in application of Articles 87 and 88 of the Treaty (General block exemption Regulation). OJ L 214, 9.8.2008, p. 3–47.

²⁷ According to Heimler, following the adoption of SAAP, the European Commission has been particularly strict in relation to restructuring aids granted to firms facing a crisis. According to the author, this approach does not take in consideration the fact that if the restructuring aid is not granted the undertaking will probably face bankruptcy proceedings. By exiting the market, the degree of market concentration could increase, strengthening the market power of the remaining undertakings active in the market.

HEIMLER ALBERTO, *European State Aid Policy in Search of a Standard. What is the Role of Economic Analysis?*

Published as SSRN working paper on 22.10.2009. The paper is available at:

http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1492585 (24.1.2012).

TFEU.²⁸ In spite of these criticisms, the more economic approach included in SAAP has been welcomed from several commentators, since it has made State aid analysis more complex and more objective.²⁹ Furthermore, the EU Commission has achieved its long term goal of decreasing the amount of aids granted by MS. As shown by the latest State Aid Scoreboard published by DG Competition in December 2011, the overall amount of State aid has been on a downward trend since the 1980s, when it represented approximately 2% of its EU GDP.³⁰ In 2011, in fact, the total amount of aid granted by MS represented only 0,6% of the EU GDP.³¹ This figure does not take in consideration the aids granted by MS to save financial institutions since the beginning of the financial crisis in 2008.³² However, if we accept the EU Commission's conviction that the aid schemes to the financial institutions represent only a temporary framework, this figure well represent the downward trend that the EU Commission claims in order to justify the effectiveness of its State aid policy.

2.3. Decentralization of State aid enforcement: lessons from CEECs?

The second objective of the SAAP was to achieve a decentralization of State aid enforcement. Following the examples of Reg. 1/2003, which decentralized the enforcement of competition law in the EU,³³ in SAAP the EU Commission proposed the establishment of

²⁸ KAUPA CLEMENS, *The More Economic Approach – A Reform Based on Ideology?* Vol 3 European State Aid Law Quarterly 311-322 (2009).

²⁹ For instance, most of the comments received by DG Competition in relation to SAAP were supportive in relation to the more economic analysis by the European Commission in that policy document. European Commission, *Results of the Consultation on the State Aid Action Plan (SAAP) – Detailed Summary*. Page 10. Published on 9.2.2006. The text of the report is available at: http://ec.europa.eu/competition/state_aid/reform/comments_saap/saap.pdf (24.1.2012).

³⁰ European Commission, *State Aid Scoreboard. Report on State Aid Granted by the EU Member States*. Published on 1.12.2011. COM (2011) 848 final. Page 6.

³¹ *Ibid.*

³² In the State aid scoreboard, the EU Commission differentiates between crisis and non-crisis aids. While non-crisis aids represent 0.6% of the EU GDP, crisis aids represent approximately 8% of the EU GDP, equivalent to 4.6 trillion €. The crisis aids probably represent the highest pick of subsidies granted by EU MS since the entry into force of the Rome Treaty. However, it is important to bear in mind that most of the crisis aids were not granted through direct transfers to the financial institutions affected by the financial crisis; they rather represented guarantees temporary granted by MS to ensure the liquidity of financial institutions. According to the editor of the European State Aid Law Quarterly, most of the crisis aid “was thus only aiming at reinforcing confidence but was actually not aid: in other terms, it was injected in confidence rather than in the economy.”

Ibid, page 5.

Editorial, *Euro 4.6 trillion €*. Vol. 1 European State Aid Law Quarterly 3 (2011).

³³ Reg. 1/2003 decentralized the enforcement of competition law in view of the enlargement of CEEC. The Regulation, in fact, entered into force on 1.5.2004. Reg. 1/2003 required MS to establish NCAs, in charge of enforcing both national and EU competition law in parallel.

independent State aid monitoring authorities in every MS.³⁴ The latter could be involved in the detection and provisional recovery of illegal aids, as well as in the execution of the recovery decisions adopted by the European Commission. In SAAP, the EU Commission referred to the case of the State aid monitoring authorities established in CEECs during the pre-accession phase as a positive example which could be implemented in the other EU MS.³⁵

The establishment of the independent monitoring authorities was one of the peculiarities of the 2004 enlargement. During the previous phases of enlargement, the EU candidate countries were not required to modify their aids schemes until the moment of their accession to the EU; the aids granted before the EU accession were considered existing aids, which were monitored by the EU Commission after the moment of accession, but they did not need to be notified. As noted by Kuik, in the early 1990s CEECs went through a painful process of economic transition; a large number of restructuring aids were granted by CEECs to their former State owned companies recently privatized.³⁶ Following the Copenhagen European Council in 1993, the EU Commission realized the tremendous challenge that it would have faced in monitoring the restructuring aids granted by CEECs once these countries joined the EU.³⁷ Consequently, the requirement to establish national State aid monitoring authorities in charge of enforcing a national State aid policy during the period of the pre-accession was included in the European Agreements (EAs) concluded by the EU with CEECs in the 1990s. Furthermore, throughout the pre-accession phase the EU Commission emphasized that the enforcement of a national State aid control was an essential requirement that CEECs should comply in order to close the negotiations on the competition chapter.³⁸

In view of the obligations included in the EAs and under the pressure of the EU Commission, CEECs adopted State aid legislation, and they established national monitoring authorities. However, the independence of these institutions was sometimes “dubious”. In particular, in most

Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty. OJ L 1, 4.1.2003, p. 1–25

³⁴ *Supra*, SAAP, para. 51.

³⁵ *Supra*, SAAP, para. 51.

In support of the decentralization of State aid enforcement see:

NICOLAIDES PHEDON, *Decentralised State Aid Control in an Enlarged European Union: Feasible, Necessary or Both?* Vol 26, Issue 2 World Competition 263-276 (2003).

³⁶ KUIK KRZYSZTOF, *State Aid and the 2004 Accession – Overview of Recent Developments*. Vol 3 European State Aid Law Quarterly 366 (2004).

³⁷ *Ibid.*

³⁸ *Ibid.*

of the EU candidates MS State aid control was carried out by an “independent” branch of the Ministry of Finance, rather than by a separate authority.³⁹ One of the few exceptions was represented by Poland, where the competence to enforce the national State aid policy was assigned to the President of the National Competition Authority (NCA).⁴⁰ The institutional design which characterized most of CEECs could generate doubts in relation to its effectiveness, since Ministry of Finance “granted”, “notified”, “monitored” and eventually it “recovered” the unlawful aid. One could probably argue that a system in which the same institution designs a subsidy scheme in “the morning”, and later it sanctions the scheme “in the afternoon” under the State aid rules does not have any chance to work out. As mentioned in the introduction, by delegating State aid control to a supranational body like the EU Commission, the EC founding fathers aimed at avoiding such internal system of self-control. Nevertheless, the EU Commission’s annual reports on the CEECs during the pre-accession phase were positive in relation to the functioning of this internal system of control. The effectiveness of this monitoring system might be explained by the date in which the State aid law was adopted by CEECs. After several delays, State aid law was adopted by CEECs only in the final phase of the accession negotiations,⁴¹ when the conditionality exercised by the European Commission was strongest.⁴² CEECs thus voluntarily accepted to self-restraint their budget expenditure in view of the imminent EU accession, well aware that after having gained the EU membership they would have been released by this self-monitoring duty.

³⁹ This was the institutional setting implemented in Slovenia, Estonia, Hungary, and Czech Republic. On the other hand, in Latvia State aid policy was enforced by an inter-ministerial State aid commission supported by an office within the Ministry of Finance. For further information see:

- BEDNAR JOSEF, LAGZDINA DAIGA, CEMNOLONSKIS SIGITAS, *State Aid Control Procedures in the Czech Republic, Latvia and Lithuania before and after Accession*. Vol 2 European State Aid Law Quarterly 265-273.
- HARGITA ESZTER, REMETEI FILEP ZSUZSANNA, *State Aid Control in Hungary*, Vol. 4 European State Aid Law Quarterly 585-590 (2004).
- JAGODIC-LEKOCEVIC LEA, PELKA PIOTR, VOSU AIME, *Future Role of the Former National Monitoring Authorities and Existing Aid in Slovenia, Poland and Estonia*. Vol 3 European State Aid Law Quarterly 375-384 (2004).

⁴⁰ *Supra*, PACZKOWSKA-TOMASZEWSKA ALEKSANDRA, KRZYZTOF JAROS, KRZYSZTOF WINIARSKI.

⁴¹ In particular, among CEECs which joined the EU in 2004, Hungary and Latvia adopted a State aid law in 1997; Estonia in 1998; while Lithuania, Poland, Slovenia adopted a State aid law only in 2000.

⁴² For instance, in Romania the State aid law was adopted in April 2001. During the 2002 and 2003 progress reports, the EU Commission constantly demanded for an improvement of the enforcement record of the State aid law. In particular, the lack of notifications and the lack of implementation of the recovery decisions adopted by the State aid commission were ones of the main concerns of the European Commission. However, the degree of compliance with the State aid law by different branches of the State acting as aid grantors substantially improved in 2004, and this factor allowed Romania to close the negotiations on the competition chapter in December 2004.

VON BORRIES REIMER, *State Aid Control in Romania*. Vol 3, European State Aid Law Quarterly 509-517 (2006).

Following the EU accession, the State aid monitoring authorities in CEEC have changed their functions; rather than analyzing and deciding on aids schemes internally notified, they act as national contact points for the EU Commission. In particular, they often provide opinions to aids grantors in relation to the compatibility of the aid scheme with EU State aid rules; such opinions are non-binding, and they do not replace the notification of the aid scheme to the EU Commission.⁴³ Furthermore, in some CEECs State aid authorities provide binding opinions on whether aids schemes do not need to be notified to Brussels, since they fall within the exemptions provided by the *De Minimis* and the Block Exemptions Regulations. Finally, they keep updated a national State aid inventory, and they perform functions of advocacy *vis a vis* national and local aids grantors.

The choice of the EU Commission to require CEECs to establish national monitoring authorities was justified by the special phase of transition faced by CEECs at the beginning of the 1990s. Such choice proved to be successful in the context of the EU enlargement. Nevertheless, in the lack of EU enlargement conditionality, such institutional design could not be replicated in other EU MS. In fact, the EU Commission's proposal to require every EU MS to establish an independent State aid monitoring authority received "the highest disapproval level of all the proposals for modernizing State aid policy" proposed in SAAP.⁴⁴ In particular, concerns related to the different degree of independence of State aid authorities in the different MS, the fear of increased bureaucracy at the national level, and the lack of incentives for the old MS to establish effective internal systems of State aid control in the lack of the EU enlargement conditionality were claimed as the major obstacles to the practical feasibility of this proposal.⁴⁵ Following the rejection of the attempt to decentralize State aid enforcement, the EU Commission remains the only institution in the EU which can authorize notified aids. However, a number of MS besides CEECs have established national authorities which act as national contact point for the EU Commission.⁴⁶ However, the fact that the degree of independence and the tasks of these

⁴³ For a comparative analysis of the functions of State aid authorities in Slovenia, Poland and Estonia after the accession of these countries to the EU in 2004, see:

Supra, JAGODIC-LEKOCEVIC LEA, PELKA PIOTR, VOSU AIME.

⁴⁴ *Supra*, Result of the Consultation on SAAP, page 26.

⁴⁵ *Ibid*, page 27.

⁴⁶ NEGENMAN MONIQUE, *A State Aid Network?* Vol 4 European State Aid Law Quarterly 621-627 (2011).

authorities vary from country to country does not help the EU Commission in ensuring consistency in the enforcement of State aid rules throughout the EU.⁴⁷

To sum up, the EU State aid policy is the result of a long process of transition, whereby the EU Commission has preserved its autonomy from the MS even in difficult times like the current financial crisis, and it has progressively increased the degree of notification and implementation of its Decisions by the EU MS. SAAP has represented an important step in this process of development, even though its two objectives have not been equally achieved: while the more economic approach proposed in SAAP has contributed to stimulate the long term trend towards a reduction of the granted State aid, the decentralization of State aid enforcement has failed to collect sufficient consensus. In particular, in the lack of the EU enlargement conditionality, the positive experience of the State aid monitoring authorities established in CEECs has not be exported to the old EU MS.

The questions which lead us to the next section of the paper are the following ones: if the old EU MS refused to introduce national State aid monitoring authorities, why should the SEE countries follow this model? Can the positive experience of the State aid monitoring authorities in CEECs be exported to SEE countries as well?

3. State Aid Control in SEE: the Endless Transition

3.1. The international commitments requiring SEE countries to introduce an internal State aid control

Following the examples of the EAs, an obligation to introduce an internal system of State aid control was included in the SAAs concluded by the majority of the SEE countries with the EU

⁴⁷ *Ibid.*

As noted by Negenman, in most EU MS the function of State aid authority is played by an independent office within the Ministry of Finance (i.e. Germany, UK); in other MS the State aid control is played by an inter-ministerial commission (i.e. France); finally, only in a limited number of MS, especially among the new MS (i.e. Poland, Malta), State aid are reviewed by a separate body or by the NCA. These authorities coordinate the aids notifications to the EU Commission, and supervise the enforcement of its Decisions.

The only exception from this point of view is represented by Denmark, where the authorization from the Danish State aid commission under the national State aid law is compulsory before the aid can be notified to the European Commission, and reviewed under Art. 107 TFEU.

WEGENER JESSEN PERNILLE, *National State Aid Law Applied to State Aid Measures Affecting Trade between Member States – the Danish Case*. Vol 1 European State Aid Law Quarterly 59-70 (2011).

during the last decade. In particular, each SAA included a general prohibition on any State aid which could distort the competition in the market by favoring certain undertakings.⁴⁸ In addition, the SAAs included an obligation for the SEE countries to establish an “operationally independent authority” “entrusted with the powers necessary for the full application” of the State aid prohibition. The SEE countries were required to establish the State aid monitoring authority by one year after the entry into force of the SAA.⁴⁹ Moreover, by four years from the entry into force of the SAA, the State aid monitoring authority should complete a “comprehensive inventory of the aid schemes” existing in the country.⁵⁰ The establishment of the inventory was the first activity that the newly established authority should carry out. The establishment of the inventory was an important step in the development of the State aid authority, since before reviewing the new notified aids the authority should get an idea of which were the most problematic aid schemes existing in the country.

The SAAs included a specific temporal exemption from the full application of the EU State aid *acquis*: for a period of four/five years any public aid granted by SEE countries to promote the economic development of certain geographic areas could be considered exempted under Art. 107(a)(1) TFEU.⁵¹ In particular, the entire country was considered “an area where the standard of living was abnormally low” and affected by “serious unemployment”, and thus any regional

⁴⁸ The SAAs were concluded according to the following chronological order:

- SAA between the European Communities and their Member States and the Former Yugoslav Republic of Macedonia, signed on 26.3.2001. Art. 69 (1)(c) .
- SAA between the European Communities and their Member States and the Republic of Croatia, signed on 29.10.2001 and entered into force on 1.2.2005. Art. 70 (1)(c).
- SAA between the European Communities and their Member States and the Republic of Montenegro, signed on 15.10.2007, entered into force on 1.5.2010. Art. 73(1)(iii)
- SAA between the European Communities and their Member States and the Republic of Albania, signed on 12.6.2006 and entered into force on 1.4.2009. Art. 71(1)(iii).
- SAA between the European Communities and their Member States and the Republic of Serbia, signed on 29.4.2008 and entered into force on 1.2.2010. Art. 73(1)(c).
BiH signed a SAA on 16.6.2008, but it is still not in force due to the lack of ratification by the EU. In the meantime, an Interim Agreement has entered into force at the moment of the signature of the SAA. The Interim Agreement replicates in Art. 36 the same provision on State aids included in Art 71 SAA.
- Interim Agreement on Trade and Trade-Related Matters between the European Community and Bosnia and Herzegovina, signed on 16.6.2008 and entered into force on 1.7.2008. Art. 36(1)(c).

⁴⁹ Only the SAA concluded with the Rep. of Macedonia does not explicitly mentioned in Art. 69 that the general prohibition against State aids will have to be enforced by an independent State aid authority.

⁵⁰ See Art. 71(4) SAA Albania; Art. 73(6) SAA Montenegro; Art. 73(6) SAA Serbia; Art. 70(6) SAA Croatia; Art. 36(6) Interim Agreement BiH. Only the SAA concluded with the Rep. of Macedonia does not clearly spell out this obligation.

⁵¹ See Art. 69(3)(a) SAA Rep. Macedonia; Art. 70(7)(a) SAA Croatia; Art. 73(6) SAA Serbia; Art. 73(7)(a) SAA Montenegro; Art. 71(4) SAA Albania. Only BiH benefited of a six years exemption in Art. 36(7)(a) of the Interim Agreement.

development aid could be justified. However, by the end of this period of transition, the State aid authority would draft a State aid regional map for the country, indicating the maximum aid intensity per region of the country on the basis of the data concerning the GDP per capita in each region.⁵² The regional aid map would be assessed by the European Commission. The establishment of the regional aid map represented another important step in the development of the State aid authority: the period of transition of four/five years was necessary to allow the authority to collect the data concerning the economic development of the different regions of the country; statistical data which were not always accurate and updated.

Finally, a Protocol attached to the SAAs granted to the SEE countries a further exemption of five years in relation to the aids granted to the steel sector.⁵³ In particular, the SEE countries could grant State aid to steel producing firms for restructuring purposes. As it will be pointed out in the following section, only Croatia relied upon this exemption. The other SEE countries did not have an important steel industry which needed restructuring. The steel exemption was important for the CEECs, mostly facing a restructuring of the steel industry at the beginning of the 1990s when the EAs were concluded. On the contrary, this exemption was not relevant for most of SEE countries, which concluded the SAAs ten years after the beginning of the transition from socialism to capitalism. The steel Protocol is thus a good example of one of the provisions which were “copied and pasted” from the EAs to the SAAs without an assessment of the individual needs of the SEE countries.

The SAAs represented the main international commitment requiring the SEE countries to establish an internal system of State aid control. Its implementation has been closely monitored by the European Commission, which assess in the chapter on competition policy included in its annual Progress Reports the degree of adoption of the State aid law and the degree of its enforcement for each SEE country.⁵⁴ The Progress Reports represent the main indicators of the

⁵² The EU regional aid policy relies on an aid map approved periodically by the EU Commission: each EU MS is assessed “per region”, on the basis of the GDP per capita in each specific region. In particular, aid schemes granted by MS to the regions where the GDP per capita is lower than 75% of the EU average can be exempted under Art. 107(3)(a) TFEU. On the other hand, the aid schemes which benefit regions where the GDP is higher can be exempted only under Art. 107(3)(c). The latter is a more stringent condition, which requires the MS to prove that the aid scheme favor the development of a specific economic activity in a specific area. European Commission, Guidelines on National Regional aid for 2007-2013. OJ C 54, 4.3.2006, p. 13, published on 17.8.2010.

⁵³ Art. 3 Protocol 5 SAA Serbia; Art. 3 Protocol 5 Montenegro SAA; Art. 3 Protocol 1 Albania SAA; Art 3 Protocol 3 SAA BiH.

⁵⁴ Every year DG Enlargement publishes a Progress Report for each SEE country, indicating the improvements made in relation to the adoption and enforcement of the EU *acquis*, as well as the lack of implementation of certain

conditionality exercised by the EU Commission *vis a vis* the SEE countries. For instance, during the last years the EU Commission has constantly pointed out in its Progress Reports that Kosovo should establish a State aid monitoring system.⁵⁵ In July 2011, Kosovo finally adopted a State aid law, which has recently entered into force.⁵⁶ In the lack of a SAA concluded between Kosovo and the EU, the adoption of the State aid law in Kosovo was an answer to the criticism expressed by the EU Commission in its annual Progress Reports, rather than as a sign of compliance with the legal obligation included in a SAA.

Even though the SAAs represent the main international agreements which has encouraged the SEE countries to adopt a State aid law, other two sets of international commitments are worth to be mentioned: the Central European Free Trade Agreement (CEFTA)⁵⁷ and the Energy Community Treaty (EnCT).⁵⁸ Art. 21 CEFTA includes a general prohibition on State aid, and a duty for CEFTA MS to assess State aids under the conditions provided by Art. 107 TFEU. However, CEFTA agreement provides a “weak” system of enforcement of this prohibition: rather than requiring each CEFTA MS to establish a national State aid monitoring authority, the agreement provides a system of mutual withdrawal of the trade concessions similar to the WTO

aspects of the *acquis*. The Progress Reports thus represent a benchmark whereby the EU Commission assess every year the readiness of SEE to join the EU. The text of the Progress Reports for each SEE country is available at: http://ec.europa.eu/enlargement/press_corner/key_documents/reports_oct_2011_en.htm (25.1.2012).

⁵⁵ See, for instance, 2010 Progress Reports on Kosovo.

Commission Staff Working Paper, Kosovo 2010 Progress Report. SEC(2010) 1329, published on 9.11.2010. Section 4.1.5.

⁵⁶ Law 2011/04-L-024, Law on State Aid adopted by the Assembly of the Republic of Kosovo on 29.7.2011. The Law entered into force on 1.1.2012. An English translation of the text of the legislation is available at: <http://www.kuvendikosoves.org/common/docs/ligjet/Law%20on%20state%20aid.pdf> (25.1.2012)

⁵⁷ CEFTA is a free trade agreement originally established among CEEC before their accession to the EU. In view of the potential EU membership perspective, in 2006 SEE countries became CEFTA MS.

Central European Free Trade Agreement 2006, signed on 19 December 2006 in Bucharest, entered into force on 26.7.2007 for five countries: Albania, Montenegro, Republic of Macedonia, Moldova, and UNMIK; on 22.8.2007, they were joined by Croatia, on 24.9.2007 by Serbia, and on 22.11.2007 by BiH. The text of the agreement is available at:

<http://www.cefta2006.com/sites/default/files/trade/ANN1CEFTA%202006%20Final%20Text.pdf> (25.1.2012).

⁵⁸ EnCT is a treaty concluded in 2005 between the EU and the SEE countries. EnCT aimed at establishing a pan-European energy market. In particular, SEE countries are required to implement the EU *acquis* in the field of energy before their accession to the EU. In 2010, Moldova and Ukraine joined the EnCT as well.

Treaty establishing the Energy Community between the European Community the Republic of Albania, the Republic of Bulgaria, Bosnia and Herzegovina, the Republic of Croatia, the Republic of Macedonia, the Republic of Montenegro, Romania, the Republic of Serbia, and UNMIK pursuant to the United Nations Security Council Resolution 1244, signed on 25 October 2005, entered into force on 1 July 2006. The text of the EnCT is available at:

http://www.energy-community.org/portal/page/portal/ENC_HOME/ENERGY_COMMUNITY/Legal/About_the_Treaty (25.1.2012).

disputes settlement system.⁵⁹ This system of enforcement is “weak” since it depends on the willingness of a CEFTA MS to challenge another MS considered not in compliance with its duty to prohibit State aids at the internal level; willingness which is low in this field, since granting subsidies to the economy is often considered a “business as usual” by the Governments of this region.

Finally, a general obligation to prohibit State aids was also included in the EnCT concluded in 2005 between the EU and the SEE countries, as Contracting Parties of the EnCT. Under Art. 18 of the EnCT, the Contracting Parties of the EnCT shall prohibit any public aid which distorts the competition by favoring certain operators in the energy sector. Due to the broad interpretation of the concept of energy sector in the EnCT,⁶⁰ as well as due to the relevance of the aids granted to the energy sector in most of the SEE countries, this prohibition has quite important consequences. In addition, even though the EnCT does not require the establishment of State aids monitoring authorities, it provides for a more effective disputes settlement system in comparison to CEFTA.⁶¹ In particular, the Secretariat which supervises the enforcement of the Treaty can start an investigation if one of the Contracting Parties does not properly implement the terms of the Treaty.⁶² Even though the Secretariat cannot impose any direct sanction on the non-compliant Contracting Party, it can bring the case to the Ministerial Council of the Energy Community, which can withdraw the voting rights of the Contracting Party.⁶³ In addition, since the EnCT requires the SEE countries to implement the EU energy *acquis*, the SEE countries are encouraged to comply with the indications of the Energy Community Secretariat in view of their future EU membership perspective. Therefore, even though the formal sanction of voting withdrawal has never been relied upon, the Energy Community Secretariat has been successful in convincing the SEE MS to modify their energy legislation, in order to make it in compliance with the EU *acquis*. The EnCT Secretariat has opened a number of investigations related to different types of infringement of the EnCT, in the field of State aid too. In particular, in September 2010 the

⁵⁹ *Supra*, Art. 24 CEFTA.

⁶⁰ The EnCT covers every source of energy, including electricity, gas and oil.

⁶¹ Rules on disputes settlement were adopted in 2008 by the EnCT Ministerial Council in Brussels. The disputes settlement rules are available at:

<http://www.energy-community.org/pls/portal/docs/296193.PDF> (25.1.2012).

⁶² *Ibid*, Art. 10.

⁶³ *Supra*, Art. 92 EnCT.

Secretariat opened an investigation in relation to the lack of adoption of a State aid law by Bosnia and Herzegovina (BiH).⁶⁴

SAAs, CEFTA and the EnCT are the main international agreements concluded by the EU with the SEE countries during the last decade; they are good examples of the closer links established by the EU with the countries of this region after the wars which affected Western Balkans in the 1990s. Each agreement includes a general State aid prohibition, even though they provide for different systems of enforcement of this legal obligation. As we will see in the following sections, the fact that most of the SEE countries have introduced a system of State aid control shows that these international agreements have been successful. However, the degree of enforcement of the State aid rules is remarkably different in each SEE country; the enforcement record of State aid rules is more influenced by the credibility of the EU enlargement conditionality, rather than by the legal obligation stemming from these international agreements.

3.2. Institutional models of State aid enforcement in SEE

3.2.1. The State Aid Commission model: “independency” within the Government?

As mentioned in the previous section, the SEE countries have complied with their international commitments to adopt a State aid law.⁶⁵ The last SEE country to comply with this

⁶⁴ Case 1/10, Dispute settlement procedure initiated against Bosnia and Herzegovina for the failure to adopt State aid legislation. Opened on 22.9.2010. Further information on the investigations opened by the EnCT Secretariat is available at:

http://www.energy-community.org/portal/page/portal/ENC_HOME/ENERGY_COMMUNITY/Dispute_Settlement/01_10/ (25.1.2012).

⁶⁵ The State aid law of the SEE countries currently in force are:

- Albania: Law n. 9374, adopted by the Albania Parliamentary Assembly on 21.4.2005. The Law 9374/2005 was amended by the Law 10183, adopted on 29.10.2009. An English translation of the text of the legislation is available at:
http://www.mete.gov.al/doc/20060509102817_law_on_state_aid.pdf (27.1.2012).
- Croatia: State Aid Act adopted by the Croatian Parliament on 17.11.2005. Official Gazette 140/2005. An English translation of the text of the legislation is available at:
<http://www.aztn.hr/uploads/documents/eng/documents/StateAid/STATE.AID.ACT2005.pdf> (27.1.2012).
- Rep. of Macedonia: Law on State Aid Control, Official Gazette 145/2010. An English translation of the text of the legislation is available at:
<http://www.kzk.gov.mk/images/Vestiimages/904/DOWNLOAD.pdf> (27.1.2012).
- Montenegro: Law of Control of State Aid Support and Aid, adopted by the Montenegro Parliament on 9.11.2009. An English translation of the text of the legislation is available at:
<http://www.mf.gov.me/en/organization/state-aid-unit/98760/Law-on-State-Aid-Control.html> (27.1.2012).
- Serbia: Law on State Aid Control, Official Gazette 51/09. An English translation of the text of the legislation is available at:

obligation is BiH, which has adopted a State aid law only at the beginning of 2012.⁶⁶ A draft State aid law remained pending before the BiH Parliamentary Assembly for a number of years.⁶⁷ Such delay was not due to the reluctance by BiH to comply with its international commitments, but rather due to an internal debate on the institutional position of the State aid monitoring authority. In particular, since BiH is *de facto* a confederation where most of the budget expenditure is managed by the local entities rather than by the federal government, the question was whether a single State aid authority could be established at the federal level.⁶⁸

The SEE countries have implemented their obligation to establish an “operationally independent” State aid authority in accordance with two institutional models: either by establishing a State Aid Commission closely linked to the Ministry of Finance, or by granting to the NCA competence in the field of State aids. Albania, Serbia, Montenegro and Kosovo have opted for the establishment of a State Aid Commission.⁶⁹ The latter is usually an inter-governmental body which includes representatives from different Ministries and it is chaired by the Minister of Finance.⁷⁰ In particular, in every country the Commission is assisted by a State

http://www.mfin.gov.rs/download/pdf/zakoni/sektor_za_ekonomiju_i_javna_preduzeca/Law%20on%20State%20Aid%20Control,%20July%208,%202009.pdf (27.1.2012).

- Kosovo: *supra*, Law 2011/04-L-024.

⁶⁶ <http://www.delbih.ec.europa.eu/News.aspx?newsid=66&lang=EN> (13.2.2012).

⁶⁷ Study conducted by Hunton & Williams and Eisenberger & Herzog on behalf of the Energy Community Secretariat, *State Aid Rules and Effectiveness of State Aid Control in the Electricity Sector under the Energy Community Treaty*. Report presented in Brussels and Vienna on 8.4.2011. Page 25. The text of the report is available at: <http://www.energy-community.org/pls/portal/docs/948179.PDF> (27.1.2012).

⁶⁸ In 2009, Republic Srpska adopted a State aid law even though the State aid authority has not been established yet. Therefore, Republic Srpska would be in favor of the establishment of different State aid authorities in the different States, rather than a single State aid authority at the federal level.

Ibid, page 26.

⁶⁹ See: Art. 16-18 State aid law Albania;

⁷⁰ The situation is the following in the different countries:

- Albania: the State Aid Commission includes 5 members appointed by the Council of Ministers for a period of four years. The Commission is chaired by the Minister of Economic Affairs.
Supra, Art. 16 Albania State aid law
- Montenegro: the State Aid Commission includes nine members, representatives of different Ministries, as well as one representatives of the municipalities and one representative of the association of the employers.
Supra, Art. 11 Montenegro State aid law.
- Serbia: the State Aid Commission includes five members, representatives of the Ministry of Finance (chairman), Competition Authority (Deputy Chairman), Ministry of the Economy and Regional Development, Ministry of Infrastructure, Ministry of Environment.
Supra, Art. 6 Serbia State aid law.
- Kosovo: the State Aid Commission includes five members: Minister of Finance (chairman), Minister for European Integration, Minister of Trade, representative of the civil society, and chairman of the municipalities association.
Supra, Art. 8 Kosovo State aid law.

Aid Office, a separate unit placed within the Ministry of Finance.⁷¹ The latter has the task to review the notified aids and to draft the text of the decisions which will be later discussed by the State Aid Commission.

Most of the SEE countries which have established a State Aid Commission have only recently adopted the State Aid Law;⁷² therefore, it is still too early to assess the effectiveness of their State aid systems. On the other hand, Albania has been enforcing a State aid law since 2005. In particular, in 2008 the State Aid Commission completed a State aid inventory in the country, and a number of decisions have been adopted by the State Aid Commission.⁷³ However, in most of the cases the State Aid Commission has approved the notified aid schemes; the Commission has not challenged any major aid scheme.⁷⁴ Since in most of the countries the Ministry of Finance is usually the main aid provider, this institutional solution allows the State Aid Office to easily acquire reliable data about the new aids schemes. Nevertheless, as argued in the previous section in relation to CEECs, it is unlikely that the Minister of Finance, as chairman of the State Aid Commission, would sign “in the afternoon” a decision of the State Aid Commission declaring “unlawful” a State aid scheme drafted “in the morning” by a department of the Ministry of Finance.

3.2.2. The impact of the EU membership conditionality on State aid enforcement in Croatia

Croatia has opted for a different institutional setting, namely it has granted to the NCA jurisdiction in the field of State aid enforcement. In Croatia, competence in the field of State aid has been granted to the *Agencija za Zaštitu Tržišnog Natjecanja* (Croatian Agency for Competition, AZTN) since the first State aid law adopted in 2003.⁷⁵ At the moment of the adoption of the State aid law, the AZTN was already established; the AZTN, in fact, exists as a

⁷¹ See: Art. 18 Albania State aid law; Art. 10 Serbia State aid law; Art. 15 Montenegro State aid law.

One exception is represented by Kosovo, where under Art. 7 of the State aid law, the State Aid Office should be placed within the Competition Authority. However, due to the fact that the State aid law entered into force only on 1.1.2012, the State Aid Office has not been established yet.

⁷² Montenegro adopted a State aid law in November 2009; Serbia in July 2009 and Kosovo in July 2011.

⁷³ Decision of the Council of Ministers n. 45, *On Approval of Report on the Inventory of Existing State Aid Schemes in Albania*. Adopted on 16.1.2008. An English translation of the decision is available at:

http://www.mete.gov.al/doc/20100223114526_report_on_the_inventory_of_existing_state_aids_-_english.pdf (27.1.2011).

⁷⁴ The web-site of the Albanian Ministry of Finance includes some information on the most important decisions adopted by the State Aid Commission:

<http://www.mete.gov.al/rub.php?idr=88&l=a> (27.1.2012).

⁷⁵ State Aid Act of the Republic of Croatia, entered into force on 2.4.2003. Official Gazette 47/03.

separate institution from the entry into force of the competition law in 1997.⁷⁶ During the first three years of the enforcement of the 2003 State aid law, the AZTN elaborated an “adjustment program” of the existing State aid schemes in the country.⁷⁷ In particular, besides compiling a State aid inventory as requested in the SAA, the AZTN advised the different State aid providers on how they could modify their existing aid schemes in order to make them in compliance with the EU State aid *acquis*. The important task of advising State aid grantors was later strengthened in the 2005 State aid law. Under Art. 10(1) of the 2005 State aid law, in fact, any draft legislation which includes a State aid scheme has to be notified to the AZTN for its prior approval. The interesting aspect is that the AZTN’s opinion is “binding”: any draft law which includes State aids aspects “...may not be adopted by the Government of the Republic of Croatia without a positive opinion of the Agency.”⁷⁸ This provision ensures to the AZTN the opportunity to play an important function of advocacy: the AZTN can monitor *ex-ante* any draft aid even before the granting authority notifies the aid scheme to the AZTN. The Croatian NCA has relied on this provision in a number of occasions, successfully convincing the Government to modify a draft legislation in order to take in consideration its comments.⁷⁹

The binding opinions have not been the only tools relied by the AZTN in order to strengthen its authority in the enforcement of State aid rules. Following the example of the EU Commission, AZTN has strengthened its independence from the Government by relying on the EU State aid *acquis* to legitimize its decisions. In particular, since November 2006, the Croatian Government has constantly transposed at the internal level the EU Commission’s Guidelines, Interpretative

⁷⁶ <http://www.aztn.hr/o-nama/> (27.1.2012).

⁷⁷ AZTN, *Alignment Programme of the Existing State Aid Schemes to the Criteria Stipulated in Article 70 paragraph (2) of the Stabilisation and Association Agreement between the Republic of Croatia and the European Communities and their Member States*. An English translation of the document is available at: http://www.aztn.hr/uploads/documents/eng/documents/Decisions_of_the_Government/Alignment_Programme_SAA.pdf (27.1.2012).

⁷⁸ *Supra*, Croatia State aid law 2005, Art. 10(4).

⁷⁹ For instance, AZTN played an important role in the process of adoption of the radio-television law. In particular, the AZTN successfully convinced the Government to modify the mechanism to finance the public channel HRT, funded on the basis of a compulsory fee paid by every citizen. AZTN argued that the financing mechanism was discriminatory for the other private television channels which competed with HRT in the advertising market. Moreover, the public funding scheme was not directly connected to the provision of a service of general economic interest by HRT.

AZTN, *Annual Report of the Croatian Competition Agency for 2010*, published in October 2011. Page 59-61. An English version of the AZTN Annual Reports is available at: <http://www.aztn.hr/o-nama/23/annual-report/> (27.1.2012). (27.1.2012).

Notes and Block Exemptions in the field of State aids.⁸⁰ In addition, AZTN has relied on the ECJ's case law as well as on previous Decisions of the EU Commission in a specific area of State aid enforcement in order to support the result of its analysis.⁸¹ From this point of view, the AZTN has followed the example of the EU Commission: the latter has strengthened its independence *vis a vis* the EU MS by “de-politicizing” State aid enforcement through the establishment of a system of norms and case law that it relies upon to justify its decisions.

Besides advising the Government on the text of draft legislation which includes State aid aspects, the AZTN was also involved in the process of reviewing two political sensitive aid schemes, namely the restructuring of the steel and shipbuilding industries in the country. The restructuring of the steel industry started in 2007, when the Croatian Government adopted a restructuring program covering the years 2007-2013.⁸² The restructuring program included the progressive privatization of the formerly State owned steel producers; at the same time, the Government would grant a restructuring aid to decrease the negative impact of the privatization programs on the employment. The AZTN reviewed the restructuring plan, and it approved the aid schemes. In particular, it relied on the Steel Protocol included in the SEE, which allowed a more lenient approach *vis a vis* restructuring aid schemes to the steel sector until the year 2010.⁸³

The review of the restructuring aid to the shipbuilding industry, on the other hand, was a more complex matter for the AZTN. Unlike steel, in fact, this industry did not benefit from any temporary exemption under the SAA. In addition, shipbuilding was traditionally considered an industry of national interest in a country economically strongly oriented towards its long coast. At the beginning of 2000s, the Croatian State-owned shipbuilders could not cope with international competition in this sector, and they remained on the market thanks to the financial contributions

⁸⁰ In November 2006, the Croatian Government decided to transpose at the internal level the secondary legislation adopted by the EU Commission in the field of State aid. The list of EU secondary legislation has been continuously updated during the following years.

<http://www.aztn.hr/drzavne-potpore/54/decisions-of-the-government/> (27.1.2012).

Council of Ministers of the Republic of Croatia, *Decision about Publishing the List of Rules on State Aid*. Decision adopted on 2.11.2006, published on the Official Gazette 50/2006. The text of the Decision in Croatian language is available at: <http://narodne-novine.nn.hr/clanci/sluzbeni/128433.html> (27.1.2012).

⁸¹ For instance, in the case of the radio-television law mentioned above, AZTN relied on the EU Commission's Decision in relation to the Irish financing scheme to RTE and TNAG in order to justify its finding.

AZTN, *Annual Report of the Croatian Competition Agency for 2008*, published in July 2009. Page 64.

⁸² AZTN, *Annual Report of the Croatian Competition Agency for 2006*, published in July 2007. Page 47.

⁸³ *Ibid.*

received by the Government.⁸⁴ From a statistical point of view, the aid to the shipbuilding industry represented a substantial part of the total amount of State aids granted in Croatia.⁸⁵ In view of these considerations, it is not surprising that the restructuring of the shipbuilding sector represented a major test to analyze the ability of the AZTN to properly enforce State aid rules in the country, in spite of the political pressures received from other Governmental bodies.

The restructuring program of the shipbuilding sector started in 2006, when the Ministry of Economy adopted a plan to subsidize the restructuring of the major shipbuilders operating in the country for the period 2007-2012; however, the plan did not initially include any program of privatization of any shipbuilder.⁸⁶ The restructuring plan was notified to the AZTN, which in spite of the political sensitivity of the subject, adopted in February 2008 a decision rejecting the draft aid scheme.⁸⁷ In particular, the AZTN argued that the restructuring plan did not assess whether the latter would be successful in case of a change of the favorable market conditions foreseen (i.e. change in the steel worldwide price). In addition, the Ministry of Economy had not assessed whether the restructuring process could have been completed even in the lack of the subsidy, or if the aid had been subject to a lower intensity. In practice, the AZTN rejected the aid scheme since the Ministry of Economy had not performed a counterfactual analysis to justify the necessity of the subsidy; counterfactual analysis which is one of the cornerstones of the more economic approach to State aid review suggested by the EU Commission in SAAP. The approach followed by AZTN in its decision is not surprising, since the draft aid scheme was analyzed by the experts hired by European Commission, which closely cooperated with the AZTN during the entire review.⁸⁸ The cooperation with the EU Commission was a factor which certainly increased the “persuasiveness” of the AZTN’s decision; following the rejection decision, in fact, in May 2008 the Croatian Government decided to privatize the entire shipbuilding industry. The

⁸⁴ On 22.8.2002 the Croatian Government adopted a Decision whereby it committed to subsidy 10% of the sale price of the projects contracted by Croatian owned shipyards until the end of 2006.

AZTN, *Annual Report of the Croatian Competition Agency for 2008*, published in July 2009. Page 57.

⁸⁵ For instance, the 2005 EU Commission’s Progress Report noticed that the amount of State aid granted in Croatia increased from 2.8% GDP in 2002 to 3.4% of the GDP in 2004. The report underlined that such values were substantially higher in comparison to the EU average. In particular, 2/3 of the aid was granted to specific economic sectors, and among them the shipyards received the largest amount of subsidies.

European Commission, *Croatia 2005 Progress Report*. Published in Brussels on 9.11.2005, SEC(2005) 1424. Page 45.

⁸⁶ *Ibid*, page 58.

⁸⁷ *Ibid*, page 59.

⁸⁸ “During 2007, supported by the team of shipbuilding experts hired by the European Commission and the German experts from the Phase 2005 twinning project, the Agency analyzed in detail the restructuring plans for each shipyard.”

Ibid, page 58.

involvement of the AZTN in the restructuring of the shipbuilding sector did not terminate in May 2008. In particular, following the decision to privatize the industry, the Government adopted restructuring aid schemes, initially approved by the AZTN as “rescue” and restructuring schemes, taking in consideration the financial difficulties faced by the shipyards. However, in September 2010, the AZTN adopted a new decision, whereby one of the shipyards (Uljanik Brodogradilište) was not considered anymore an undertaking facing financial difficulties, and therefore the company was bound to return to the Ministry of the Economy the aid previously received.⁸⁹

The active involvement of the AZTN in the long restructuring process of the shipbuilding sector showed the independence of this institution and its ability to adopt decisions in controversial political cases. However, as mentioned in the previous paragraph, the EU Commission closely monitored the restructuration process. In particular, the support of the EU Commission to the AZTN went beyond the simple technical assistance in assessing the restructuring aid scheme presented by the Government; it included a strong element of conditionality related to the EU accession negotiations. In particular, throughout the accession negotiations, the EU Commission underlined that the completion of the restructuring of the steel and of the shipbuilding sectors were essential conditions that Croatia should comply in order to close the negotiations on competition policy.⁹⁰ In addition, under the recently signed EU accession treaty, the European Commission will continue to monitor the implementation of the previous AZTN’s decisions in these sectors. In particular, the EU Commission will be able to ask for the recovery of the aids granted to the steel and shipbuilding sectors even before the date of the Croatia accession to the EU.⁹¹

⁸⁹ AZTN, *Annual Report of the Croatian Competition Agency for 2010*, published in October 2011. Page 52.

⁹⁰ *Ibid*, page 51.

⁹¹ Two specific Protocols on steel and shipyards were included in the EU accession Treaty signed by Croatia on 9.12.2011. Under the terms of the Protocols, the EU Commission will be able to order Croatia to recover the restructuring aid granted since 2006 to the shipyards which are not anymore facing financial difficulties (i.e. Uljanik Brodogradilište). Similarly, upon the EU accession, the European Commission will be able to order Croatia to recover the State aid granted to the steel maker Sisak, if the company has not reimbursed the aid previously received.

European Commission, *Information on the Results of the EU Accession Negotiations with Croatia*. Report published in November 2011 by DG Enlargement. Page 9. The text of the report is available at:

http://ec.europa.eu/enlargement/pdf/hp/results_of_the_eu_accession_negotiations_with_croatia.pdf (2.2.2012).

3.3.3. The Macedonian NCA: the “isolated” State aid enforcer

Similarly to Croatia, the Rep. of Macedonia has also granted jurisdiction in the field of State aids control to the NCA. However, in spite of the similar institutional structure, the effectiveness of the enforcement of these rules has been quite different in the two countries. In particular, unlike the case of Croatia, the EU membership conditionality has not supported the development of an internal system of State aid enforcement in the Republic of Macedonia. The latter received the status of EU candidate country in 2005;⁹² however, since then the EU accession negotiations have never been opened due to the ongoing name dispute with Greece.⁹³ The case of the Republic of Macedonia well represent the endless transition towards EU membership that is currently affecting the SEE countries with the exception of Croatia, as well as the consequences of such long transition on the enforcement of an internal system of State aid control.

In order to comply with the SAA, the Republic of Macedonia adopted its first State aid law in 2003.⁹⁴ From a chronological point of view, the State aid law was adopted two years before the adoption of the 2005 competition act.⁹⁵ The enforcement of the 2003 State aid law was assigned to an inter-governmental State Aid Commission supported by the Ministry of Finance.⁹⁶ This institutional setting, which currently characterizes the majority of the SEE countries, proved not be successful in ensuring an autonomous enforcement of the legislation.⁹⁷ Consequently,

⁹² European Commission, *Opinion on the Application of the Former Yugoslav Republic of Macedonia for Membership of the European Union*. SEC(2005) 1425. Published in Brussels on 9.11.2005. The text of the Communication is available at:

http://eur-lex.europa.eu/smartapi/cgi/sga_doc?smartapi!celexplus!prod!CELEXnumdoc&lg=en&numdoc=505DC0562 (2.2.2012).

⁹³ For an overview of the name dispute between Greece and the Republic of Macedonia see the recent article appeared on *The Economist* on this issue:

The Economist, *Call It What You Want*. Article published on 10.12.2011. The text of the article is available at: <http://www.economist.com/node/21541400> (2.2.2012).

⁹⁴ Law on State Aid, adopted on 4.4.2003. Published on the Official Gazette 24/03. An English translation of the text of the legislation is available at:

<http://www.kzk.gov.mk/images/Vestiimages/455/DOWNLOAD.PDF> (2.2.2012).

⁹⁵ Law on Protection of Competition of the Republic of Macedonia, adopted on 11.1.2005. Published on the Official Journal 04/05. An English translation of the legislation is available at:

<http://www.kzk.gov.mk/images/LawOnProtectionOfCompetition.pdf> (2.2.2012).

⁹⁶ *Ibid*, Art. 9.

⁹⁷ For instance, the 2005 European Commission's Progress Report on the Republic of Macedonia criticized the fact that the three members of the State Aid Commission were officers of the Ministry of Finance, who exercised the function of Commissioners on a part-time basis. In addition, the State Aid Commission did not have a separate office, and it was dependent from the budget of the Ministry of Finance.

following the example of Croatia, in 2006 the functions of State aids control were transferred to the *Комисијата за заштита на конкуренцијата* (Macedonian Competition Commission, KZK).⁹⁸

During the past years, the KZK has transposed at the internal level a number of the European Commission's Block Exemptions and Guidelines in the field of State aid.⁹⁹ In addition, the 2003 State aid law has been replaced by a new legislation in 2010, which is fully in compliance with the EU State aid *acquis*.¹⁰⁰ At a first look, the fact that the Macedonian legislation is fully in compliance with the EU State aid *acquis* and that similarly to Croatia the State aid law is enforced by the NCA, rather than by an inter-governmental State Aid Commission, should guarantee the effective enforcement of this legislation. Nevertheless, by analyzing the EU Commission's Progress Reports and the KZK's annual report, it is evident that a number of deficiencies persist in the enforcement of this legislation. In particular, the number of notification of draft State aid schemes remain low; "the *ex-ante* control of State aid is partial and confined to a few large State aid providers".¹⁰¹ As explained in the next section, the low number of notifications can be partially explained by the high thresholds for block exemptions, but also by the lack of awareness by several State aid providers of their binding duty of notification.¹⁰² The KZK has tried to solve this issue by undertaking activities of competition advocacy. For instance, the text of the 2010 State aid law was transmitted to local and national State aid providers in the country, in order to remind them of their duty of notification.¹⁰³ However, it is unclear how the KZK may solve alone this issue; in particular, due to its limited human resources

European Commission, *Analytical Report for the Opinion on the Application from the Former Yugoslav Republic of Macedonia for EU Membership*. SEC (2005) 1425. Published in Brussels on 9.11.2005. Page 68.

⁹⁸ Law on Amending and Supplementing the Law on State Aid, adopted on 6.6.2006. Published on the Official Gazette 70/06. An English translation of the text of the legislation is available at: <http://www.kzk.gov.mk/images/Vestiimages/460/DOWNLOAD.PDF> (2.2.2012).

⁹⁹ <http://www.kzk.gov.mk/eng/zapis.asp?id=8> (2.2.2012).

¹⁰⁰ Law on State Aid Control, adopted on 13.11.2010. Published on the Official Gazette 145/10. An English translation of the text of the legislation is available at: <http://www.kzk.gov.mk/images/Vestiimages/904/DOWNLOAD.pdf> (2.2.2012).

¹⁰¹ European Commission, *Commission Staff Working Paper. The Former Yugoslav Republic of Macedonia 2009 Progress Report*. SEC (2009) 1335. Published in Brussels on 14.10.2009. Page 39.

¹⁰² "There is still awareness among Government institutions and the general public, including the business sector, of the notification process and of the functioning of the State aid control system in general." European Commission, *Commission Staff Working Document. The Former Yugoslav Republic of Macedonia 2006 Progress Report*. SEC (2006) 1387. Published in Brussels on 8.11.2006. Page 30.

¹⁰³ KZK, *Annual Report 2010*, published on 31.3.2011. Section 3.1. The text of the annual report in the original language is available at: <http://www.kzk.gov.mk/images/Vestiimages/950/ПРЕЗЕМИ.pdf> (2.2.2012).

and the double task of enforcing both the competition and the State aid law, the KZK does not have the capacity to detect illegal State aids. Even when the aid schemes were notified, they were often notified retroactively.¹⁰⁴ In such circumstances, the KZK is unlikely to require the State aid provider to recover the aid previously disbursed. Consequently, the numbers of decisions in which the KZK has condemned an aid scheme as unlawful and it has asked for its recovery are few, and they generally do not represent political sensitive cases comparable to the restructuring of the shipbuilding and steel sectors in Croatia.¹⁰⁵

The case of the Republic of Macedonia is interesting since it shows that even an internal State aid system enforced by a NCA can be ineffective. The comparison between the cases of the Republic of Macedonia and Croatia shows that the institutional setting is not *per se* the key factor which facilitates the enforcement of State aid rules; the key factor is rather a credible EU membership perspective. The latter is the only reason which may convince the Government and the other State aid grantors to comply with their duty of notification, as well as to implement the NCA's recovery decisions.

3.3. State aids in SEE: how many?

One of the reasons which led the EU Commission to include State aid rules in the EAs was related to the large number of restructuring aids granted by CEECs to their industries during the initial phase of the process of economic transition.¹⁰⁶ Consequently, an internal system of State aid control was needed to lead CEECs towards a long term reduction of the amount of State aid granted, in order to achieve at the moment of their EU accession a level of State aid comparable to the EU average. In introducing State aid rules in the SAAs, the EU Commission has applied the same rationale to the SEE countries, without questioning the feasibility of such model to the peculiarities of the SEE countries.

¹⁰⁴ The European Commission noticed in its 2007 Progress Report that "Unauthorized State aid granted by several Government institutions was approved retroactively (by the KZK)." European Commission, *Commission Staff Working Paper. The Former Yugoslav Republic of Macedonia 2007 Progress Report*. SEC (2007) 1432. Published in Brussels on 6.11.2007. Page 32.

¹⁰⁵ For instance, in 2008 the KZK adopted 6 decisions in the field of State aid; 4 in 2009; 5 in 2010. All these decisions have approved the notified aid.

Supra, KZK's Annual Report 2010, table 30.

¹⁰⁶ *Supra*, KUIK KRZYSZTOF (2004).

Unlike CEECs, the amount of aids granted by the majority of the SEE countries in comparison to their GDP was already comparable to the EU average when the SAAs were concluded.¹⁰⁷ With the exception of Croatia¹⁰⁸, Serbia¹⁰⁹ and BiH¹¹⁰ where restructuring aid schemes have been granted to a number of industries, during the last decade the amount of aid granted by most of the SEE countries has varied between 0.5% and 1% of their GDP.¹¹¹ A number of reasons may explain these statistical data: first of all, it could be argued that a large part of the aid granted by SEE countries support agricultural sector.¹¹² However, due to the fact that fishery and agricultural aids are out of the scope of State aid law, reliable statistics concerning this type of aids do not exist. Secondly, since in a number of SEE countries a number

¹⁰⁷ As mentioned above, according the 2011 State Aid Scoreboard published by the EU Commission, in 2011 the EU average amount of aid corresponded to 0.6% of the GDP, taking in consideration only non-crisis aids.

Supra, 2011 State Aid Scoreboard, page 5-6.

¹⁰⁸ The total amount of State aid granted in Croatia was equivalent to 3.59% of the GDP in 2007. A substantial share of this aid targeted the shipbuilding sector. However, following the privatization and restructuring of this industry, the total amount of State aid granted in Croatia has progressively declined. It was equivalent to 2.79% GDP in 2008, and 2.61% GDP in 2009.

AZTN, *Annual Report on State Aid for 2009*. Published in Zagreb in November 2010. Page 7. An English translation of the report is available at:

http://www.aztn.hr/uploads/documents/eng/documents/AR/Annual_Report_on_State_Aid_for_2009.pdf

(8.2.2012).

¹⁰⁹ In 2010, the amount of aids granted in Serbia corresponded to 2.64% of the GDP. This figure declined in comparison to 2009, when it represented 2.86% of the GDP.

Commission for State Aid Control, *Report on State Aid Granted in the Republic of Serbia in 2010*. Published in Belgrade in June 2011. Page 4. An English translation of the report is available at:

<http://www.mfin.gov.rs/UserFiles/File/drzavna%20pomoc/Report%20on%20granted%20state%20aid%202010.pdf>

(8.2.2012).

¹¹⁰ In 2008, direct subsidies to the industry and to the agricultural sector amounted to 1.5% of the BiH's GDP. The majority of the aids were granted to loss making State-owned companies

European Commission, *Commission Staff Working Paper. Bosnia and Herzegovina 2009 Progress Report*. Published in Brussels on 14.10.2009. SEC (2009) 1338. Page 30.

¹¹¹ For instance, the 2010 EU Commission's Annual Report for Montenegro pointed out that "the weight of subsidies in the consolidated budget has been historically low, accounting for less than 1% of GDP on average since 2003." The same conclusion has been achieved by the EU Commission in relation to the Republic of Macedonia in its 2010 Annual Report on the country. Finally, the amount of State aid in Albania varied between 0.56% of the GDP in 2006 to 0.40% of the GDP in 2008.

European Commission, *2010 Progress Report Montenegro*. Published in Brussels on 9.11.2010. SEC (2010) 1334. Page 48.

European Commission, *2010 Progress Report on the Former Yugoslav Republic of Macedonia*. Published in Brussels on 9.11.2010. SEC (2010) 1332. Page 30.

Decision of the Council of Ministers n. 630, *On Approval of State Aid Annual Report 2008*. Adopted on 11.6.2009. Page 13. An English translation of the annual report is available at:

http://www.mete.gov.al/doc/20100223114606_annual_report_2008.pdf (27.1.2012).

¹¹² For instance, in 2009 43.99% of the total amount of aids granted in Croatia concerned the agricultural sector, and thus it was outside the scope of the State aid law. Similarly, in 2010, 29.9% of the total amount of aid granted in Serbia targeted the agricultural sector.

Supra, 2009 AZTN's report on State aids. Page 12.

Supra, 2010 State aid report for Serbia. Page 8.

of local State aid providers are still reluctant to notify new aid schemes to the State aid authority, these statistics may not take in consideration some un-notified aid schemes.¹¹³ Thirdly, and most importantly, the SEE countries have started to enforce an internal State aid system one decade after the beginning of the transition process from socialism to capital economies. As an example, only Croatia has relied on the temporary exemption granted in the SAA in relation to the restructuring aids for the steel sector. On the contrary, the other SEE countries did not need to rely on this temporary exemption since they had already completed the restructuring process of their steel industries in the 1990s.

Statistics concerning the types of granted aids show that in most of the SEE countries the percentage of vertical aids is larger in comparison to horizontal aids.¹¹⁴ Aids are usually granted through direct subsidies and tax exemptions schemes, rather than through forms of State's equity participation in the capital of private undertakings.¹¹⁵ Vertical aids often target former State-owned utilities which have been privatized during the last decade. In particular, subsidies to the electricity sector represent an important component of the overall State aid expenditure in some SEE countries (i.e. Albania).¹¹⁶ Vertical aids are granted both to producers (i.e. aids granted to electricity generators to subsidize the construction of new power plants), as well as to final

¹¹³ For instance, the 2010 EU Commission's Annual Report for Serbia pointed out that the "amount of subsidies could be underreported as the State schemes as well as individual State aid are not systematically referred for prior approval (to the State Aid Commission)".

European Commission, *Serbia 2010 Progress Report*. Published in Brussels on 9.11.2010. SEC(2010) 1330. Page 29.

¹¹⁴ In 2008, vertical aids represented 46.60% of the total amount of aid granted in Montenegro, against 48.47% granted for regional aid and 4.93% granted for horizontal aid. Statistics for the year 2009 saw a sensible increase of horizontal aid up to 65.8% and a decrease of vertical aid (33.92%). However, this change was achieved by considering restructuring aid as horizontal, rather than vertical aid. The other classical components of horizontal aid (i.e. employment, training, aids to SMEs, environmental aid) remain low even in 2009.

State Aid Control Commission, *Annual Report on State Aid Granted in Montenegro in 2009*. Published in Podgorica in June 2010. Page 7. An English translation of the report is available at:

<http://www.mf.gov.me/en/organization/state-aid-unit/98762/sta.html> (8.2.2012).

¹¹⁵ For instance, in 2009, direct grants represented 60.89% of the aids granted in Croatia, followed by State guarantees (27.76%), and forms of tax exemptions (10.03%). On the contrary, equity participations counted only for 0.05% of the total amount of aids granted.

Similarly, in 2010 in Serbia 92.6% of the total amount of aids was granted as direct grants, followed by tax incentives.

Supra, 2009 AZTN's report on State aids. Page 9.

Supra, 2010 State aid report for Serbia. Page 19.

¹¹⁶ For instance, in 2007 the amount of State aid granted in Albania substantially increased, moving from 0.61% of GDP in 2006 to 1.2% of the GDP in 2007. This sharp increase was due to an exceptional subsidy granted by the Government to finance the import of electricity. The extraordinary measure was due to a dry season, which caused a shortage of electricity in the country, since Albania depends mostly on hydro-power generation plants.

Supra, 2007 report of the Albanian State Aid Commission. Final conclusions.

commercial customers negatively affected by the rise of the utilities' tariffs following the privatization of the industry.¹¹⁷

Another peculiarity of the State aids granted in the SEE region relates to the “minimum” amount of aid granted to individual aid recipients. In transposing the EU State aid *acquis* at the internal level, the SEE countries have also implemented the EU *De Minimis*¹¹⁸ and Block Exemption Regulation for Aids to Small and Medium Enterprises (SMEs).¹¹⁹ However, the parameters included in these EU regulations do not fit with the economic reality of the SEE countries.¹²⁰ In particular, 99% of the undertakings operating in the SEE countries satisfy the EU definition of SMEs,¹²¹ since they have less than 250 employees.¹²² Similarly, the criterion of granting a maximum aid of 100.000/200.000€ to the same beneficiary over a period of three year does not represent a *de minimis* type of aid in these countries; it is sometimes a “catch-all exemption” relied by the local Governments to grant “large” aids in comparison to the size of these economies to a dispersed number of aid recipients.¹²³

¹¹⁷ For an overview of the specific aid schemes granted in the energy sector by SEE countries see part II of the study conducted by Hunton and Williams (*supra*).

¹¹⁸ Under Art. 2 of the *De Minimis* Regulation, aids which amount to less than 200.000€ over a period of 3 fiscal years and that benefit the same undertaking do not need to be notified to the EU Commission. Such ceiling is lower for aids granted to the transports sector (100.000€).

Commission Regulation (EC) No 1998/2006 of 15 December 2006. OJ L 379 of 28.12.2006.

¹¹⁹ Under Art 15 of the General Block Exemption Regulation, aid schemes which have an aid intensity of less than 10% for small enterprises and less than 20% for medium enterprises do not need to be notified to the European Commission.

Supra, General Block Exemption Regulation for State Aids, Art. 15.

¹²⁰ A similar conclusion was also achieved by: BIEGUNSKI LECH, *Sensitivity of Sectors and the Need of State Aid Reforms in Economies in Transition*. Vol. 4 European State Aid Quarterly 668 (2009).

¹²¹ The EU Commission's Recommendation 2003/361/EC defines the “small” enterprises as the undertakings which have less than 50 employees and an annual turnover of less than 10 million €, while the “medium” enterprises have less than 250 employees and an annual turnover of less than 50 million €.

European Commission's Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises. OJ L 124/36, 20.5.2003.

¹²² This is the case, for instance, in Croatia. According to 2005 EU Commission's Annual Report, 99.5% of Croatian undertakings were SMEs, which employed 60% of the labor force in the country.

European Commission, *Croatia. 2005 Progress Report*. Published in Brussels on 9.11.2005. SEC (2005) 1424. Page 45.

¹²³ For instance, the Albania State Aid Commission pointed out in its 2007 report that “...the majority of schemes providing State aid do not exceed the current EU *de minimis* threshold and thus do not raise any problems from an international trade perspective.”

Decision of the Council of Ministers n. 1230, *On Approval of State Aid Annual Report 2007*. Adopted on 9.7.2008. Chapter 1. An English translation of the annual report is available at:

http://www.mete.gov.al/doc/20100223114545_annual_report_2007.pdf (27.1.2012).

The statistics mentioned above shows the ineffectiveness of the application of the EU State aid rules in the SEE countries. Most of these countries did not need an internal State aid system since the overall amount of aid granted was lower in comparison to the aids granted by CEECs in the 1990s. Secondly, the EU State aid rules do not fit with the economic reality of these countries, since the *de minimis* and block exemption thresholds are too high for these economies. Finally, the shift from vertical to horizontal aids, indicated by the EU Commission in SAAP as one of the main goals of its new State aid approach, has not been achieved in SEE countries.

Statistics show that even after the adoption of the State aid law, the overall amount of aids granted in comparison to the GDP has not decreased systematically in every SEE country following the adoption of the State aid law. In particular, in some countries (i.e. Montenegro) the overall amount of State aid granted has increased even after the adoption of the State aid law.¹²⁴ Governments in SEE countries do not abstain from granting aids either due to a belief that subsidizing the economy is not in itself efficient, or due to the enforcement of the State aid law as such. The majority of the SEE countries grant a limited amount of State aids due to their limited financial resources. However, if more financial resources were available, the local Governments would not hesitate in investing the additional resources in aid schemes aimed at attracting foreign investors in the country.¹²⁵ A sentence quoted by the 2007 Annual Report of the Albanian State Aid Authority well summarize this intuition: "...even though State aid in Albania is currently low (at approximately 1.2% GDP), there is potential for growth in overall State aid in Albania as the country moves forward on the development path envisaged by the National Strategy for Development and Integration and the implementation of various sectorial strategies, including those related to industrial policy, tourism and regional development. In particular, there is a need

¹²⁴ In Montenegro, for instance, the amount of State aid progressively increased from 2007 (when it represented 0.88% of the GDP) to 2009 (1.68% of the GDP). This trend was irrespective of the approval of the State aid law in 2009.

Supra, 2009 State aid report in Montenegro, page 3.

¹²⁵ As argued by Kekic, a number of SEE countries have introduced tax incentives systems during the last decade in order to attract foreign investors. Unlike CEECs, the political instability which characterized SEE during the 1990s has slowed down the in-flow of FDIs towards this country. Only during the recent years this trends has started to change.

KEKIC LAZA, *Foreign Direct Investment in the Balkans: Recent Trends and Prospects*. Vol. 5, Issue 2 Southeast European and Black Sea Studies 171-190 (2005).

for the country to grant State aids in order to attract FDIs, since the image of Albania as investment destination remains poor”.¹²⁶

4. Conclusions

Following the example of the EAs, during the last decade the EU Commission has included State aid rules in the SAAs concluded with the SEE countries. The paper aimed at assessing the effectiveness of the internal systems of State aid control introduced in SEE countries during the last decade. In particular, the paper analyzed the concept of “effectiveness” under two points of view: the ability of the State aid authority to actively enforce the State aid rules even in political sensitive cases, as well as the ability of this set of rules to achieve a long term reduction of the overall amount of aids granted by SEE countries and a shift from vertical to horizontal types of aids. The latter, in fact, have become the goal of the new State aid policy of the European Commission after the adoption of SAAP in 2005.

The paper has shown that the first criterion of effectiveness has not been satisfied by the majority of the State aid authorities in SEE countries. Not surprisingly, the inter-governmental State Aid Commissions which exist in several SEE countries (i.e. Serbia, Montenegro, Albania and in the future in Kosovo) have not actively enforced these rules. The State Aid Commissions are unlikely to prohibit any State aid scheme, since the Commissioners are often directly involved in the process of drafting such schemes. Consequently, the State Aid Commission is likely to take in consideration the industrial policy goals of the aid schemes, rather than the ability of the subsidy to solve market failures and not to distort the competition in the market. The comparison between the cases of the Rep. of Macedonia and Croatia has shown that assigning the task of State aid review to the NCA does not *per se* ensures that this set of rules will be properly enforced. In particular, the case of the KZK shows that a NCA may become an “isolated” institution, which does not receive notification from the aid grantors and whose decisions are not properly implemented. The paper has shown that the AZTN has been successful in enforcing State aid rules in Croatia even in politically sensitive cases, like the restructuring of steel and shipbuilding industries. However, the paper has emphasized that the AZTN has been successful in these cases due to the external support of the European Commission. In particular, the EU Commission has included the restructuring of these two industries among the requirements that

¹²⁶ *Supra*, 2007 State aid annual report for Albania. Section 2.3.

Croatia had to comply in order to close the EU accession negotiations. Similarly to CEECs, the internal system of State aid control in Croatia has been successful due to its clear EU membership perspective; clear perspective which is currently lacking for the Rep. of Macedonia, which received the EU candidate status in 2005 but it has not opened yet the accession negotiations with the EU Commission.

The paper has shown that the introduction of an internal system of State aid control in SEE has been ineffective to achieve a systematic decrease of the overall amount of subsidies granted by SEE countries. In particular, in some countries (i.e. Montenegro) the overall amount of granted subsidies has even increased after the entry into force of the State aid law. Therefore, with the exception of Croatia, statistics show that for the majority of the SEE countries there has not been a direct causality between the introduction of the State aid law and the trends in the amount of subsidies granted in the economy. The paper has stressed that at the moment of the adoption of the State aid law most of SEE countries were granting less aids in comparison to CEECs at the beginning of the 1990s. This is due to the fact that CEECs concluded EAs at the beginning of their process of transition from centrally planned to market economies, while SEE countries have concluded SAAs one decade later. In addition, most of SEE countries have granted a relatively little amount of State aid due to the lack of internal resources to finance industrial policy plans. Nevertheless, it is evident that if the Governments of these countries had more resources available they would increase tax incentives to attract FDIs, which have been lacking in most of SEE countries.

The decentralization of the enforcement of State aid rules proposed by the EU Commission in SAAP was rejected by the majority of the EU MS. The positive examples of the CEECs could not be transposed to the other EU MS. The internal system of State aid control in CEECs was successful since it was temporary; limited to the EU pre-accession phase. In view of their future membership perspective, CEECs accepted to self-restraint their budget expenditures. This logic has worked out for Croatia, but not for the other SEE countries, due to their endless transition towards EU membership.

The establishment of national State aid authorities may have positive effects. In particular, the latter can elaborate a database of the existing aids granted in the country, they can play the role of national contact point for the EU Commission, and they can carry out a function of

advocacy by commenting draft legislation which includes State aid aspects (i.e. see the case of the AZTN in Croatia). Nevertheless, national State aid authorities should not be granted the decision-making power to review and approve national State aid schemes. The power to review and approving/rejecting the notified aid schemes should be granted only to a supranational authority, which is more likely to preserve its autonomy from the aid grantors. The policy conclusion suggested by this paper is thus the European Commission should have the power to review notified national aid schemes of the EU candidate countries since they gain the EU candidate status. This task, in fact, cannot be delegated to a national authority; the latter, in fact, will be able to actively review the national aid schemes only if its country has a clear timeframe to join the EU. If the EU Commission was not willing to carry out this task, other supranational bodies could be required to play this function. As mentioned in the previous pages, a system of State aid control exist also within the Energy Community Treaty in the field of energy. The Energy Community Secretariat has been willing to open investigations on the lack of adoption by BiH of the State aid law. In view of the relevance of subsidies granted by SEE countries in the electricity and gas sectors, the Secretariat could be granted the function to review the aid schemes notified by SEE countries.

The EC founding fathers were well aware that the EU MS would have not be willing to self-enforce a system of State aid control, and thus they delegated this function to a supranational body like the European Commission. This logic is still valid today, both for the EU MS, and as well as for the SEE countries, which hopefully sooner rather than later will complete their transition to join the EU family.